Access to Microfinance & Improved Implementation of Policy Reform (AMIR Program)

Funded By U.S. Agency for International Development

A Review of
The Laws and Regulations Related to the Provision of Financial Services to Small and Micro Enterprises in Jordan

DRAFT Report

Deliverable for the Legal Review Sub Task - Milestone # 5
Contract No. 278-C-00-98-00029-00

June 1998

A Review of
The Laws and Regulations Related to the Provision of Financial Services to Small and Micro Enterprises in Jordan

Summary

This consultancy addresses the impediments that impact the development of a sustainable microfinance industry in Jordan. In its scope, the consultancy will aim at focusing on the legal factors adversely affecting the growth of the microfinance industry in Jordan including, but not limited to, secured financing, stamp duties, the legal enforcement system, attorney fees, investment promotion laws and the Othmani Law.

The expertise of senior banks officers has been sought in order to identify the existing impediments which hamper the growth of micro finance industry and the remedies and actions that can be taken to develop and promote same.

The consultancy came out with some recommendations to the effect of facilitating the development of a financially sustainable micro finance industry in Jordan based on internationally accepted micro finance best practice.

It is our opinion that the main factor which is adversely affecting the growth and development of the microfinance industry in Jordan is the absence of a modern secured financing law which gives banks some assurance that loans made to micro enterprises will be repaid, and which allows them to take and enforce security interests in marketable moveable assets of their borrowers. The effect of this factor in the context of microfinancing is dealt with in a detailed manner in this consultancy. However, we found that other issues may also have an adverse effect on the microfinance industry in Jordan but this effect is not as substantial as that of the absence of a secured financing system.

One: Secured Financing Law

Economic development in Jordan is being unnecessarily hampered by inadequate legal structures for secured financing of businesses and agriculture. Banks supply most of the commercial loans to the private sector. However, for the most part, banks accept only real estate as collateral for their loans or personal guarantees of someone who owns real estate. The banks do not accept inventory, accounts receivable, livestock or industrial equipment as collateral. This is because both the Jordanian Civil Code and the Commercial Code do not provide for an adequate legal system whereby banks could lend against the security of movable property. Therefore, the secured financing on the security of movable property that does exist is confined to mortgages on registered motor vehicles.

Under the existing conditions it is difficult for anyone without real estate to finance the purchase of equipment, inventory or livestock. Businesses in rented quarters and farmers who work on rented land or who have unclear title have very limited access to credit. These conditions restrict profitable and socially useful lending by banks as well as credit sales by producers, importers and merchants and lead to unnecessarily high interest rates, volumes of lending and investment that fall short of socially profitable needs and lower output and incomes. The problem is generally not one of excessively conservative lending policies of the banks, the lack of interest in making credit available or unduly restrictive banking regulations but whether the non-existence of a practical and secured system for obtaining security interests on movables.

In order for loan capital to be available, lenders (including banks, insurance companies, equipment lessors and other credit grantors) must be convinced that the loans they make will be repaid. In order to give some assurances that the loans made to commercial enterprises will be repaid, lenders must be given the ability to take and enforce security interests in marketable assets of their borrowers. The merchant's inventory and the accounts generated by the sale of it, the farmer's equipment, livestock and crops, the construction equipment and accounts of the contractor and the equipment, finished products and accounts of the manufacturer can serve as these marketable assets. What is required is a legal regime that facilitates their use as collateral.

In response to the needs discussed above and the necessity of establishing a modern secured financing system, the Government of

Jordan has commissioned our office in conjunction with the Law & Arbitration Center to study and analyze the impediments in the context of secured financing and to draft a modern secured financing law which gives banks some assurance that loans made to commercial enterprises will be repaid, and which allows them to take and enforce security interests in marketable moveable assets of their borrowers. The proposed draft of the said Law is still being finalized and it is expected it shall be completed and submitted to the Government of Jordan in order to bring it into force by the end of 1998.

The proposed Security Interests in Movable Property Law addresses principally two types of secured financing devices: security agreements and leases of movable property (generally equipment). While in traditional legal terms these two types of transactions have little in common, this is not the case in practice. Often leasing is used as an alternative to secured financing as a method of acquiring equipment. Many leases are drawn in such a way that, in economic effect, they are not leases at all, but are secured financing devices. Third party deception is just as much a problem where a lessee is in possession of equipment as it is where a debtor is in possession of collateral.

The solution to this problem is registration and self-remedy enforcement system. The proposed draft of the Security Interests in Movable Property Law establishes with the Ministry of Industry and Trade a registry system in which secured lenders' security interests are registrable. Once a security interest is entered into the registry, it shall have priority over unregistered security interests that relate to the same collateral. Article (89) of the said draft provides as follows:

> "For realizing the purposes of this Law, a Register shall be established at the Ministry for the purpose of registration of Security Interests created pursuant to this Law. Said register shall be called "The Security Interests in Movable Property Register" and it shall be supervised by a Registrar to be appointed by the Minister. The terms and conditions of registration procedures and requirements shall be prescribed in regulations to be issued under this Law."

Unlike the Jordanian Civil Code and the Commercial Code, the Proposed Law contains an enforcement chapter that provides a secured creditor with self-remedy devices in case of default by the debtor. The Secured lender may request the Execution Office to seize the collateral in order to sell it in public auction. In this regard, Article (54) of the said Law provides as follows:

"In the event that the Debtor fails to comply with the terms of payment of the Secured Debt, fails to perform any of his obligations on the date of its maturity, or upon the occurrence of any other event or set of circumstances which, under the terms of the Security Agreement, entitles the Secured Party to enforce his interest on the Collateral, the Secured Party may:

a. Where the Collateral is a debt due to the Debtor from a third party, as in an assignment of an account; request the person obligated to pay the debt to make payment to the Secured Party, or to any person that the Secured Party may designate, the amount of the Secured Debt due from such person. The Secured Party shall be entitled to deduct from such amount the collection expenses that the Secured Party incurred.

b. Where the Collateral is a tangible movable, to request the seizure and sale of such Collateral in accordance with the subsequent provisions of this Chapter (8)."

Relevant Legislation:

Security Interests in Movable Property Law:

Article (89)

For realizing the purposes of this Law, a Register shall be established at the Ministry for the purpose of registration of Security Interests created pursuant to this Law. Said register shall be called "The Security Interests in Movable Property Register" and it shall be supervised by a Registrar to be appointed by the Minister. The terms and conditions of registration procedures and requirements shall be prescribed in regulations to be issued under this Law.

Article (54)

In the event that the Debtor fails to comply with the terms of payment of the Secured Debt, fails to perform any of his obligations on the date of its maturity, or upon the occurrence of any other event or set of circumstances which, under the terms of the Security Agreement, entitles the Secured Party to enforce his interest on the Collateral, the Secured Party may:

a. Where the Collateral is a debt due to the Debtor from a third party, as in an assignment of an account; request the person obligated to pay the debt to make payment to the Secured Party, or to any person that the Secured Party may designate, the amount of the Secured Debt due from such person. The Secured Party shall be entitled to deduct from such amount the collection expenses that the Secured Party incurred.

b. Where the Collateral is a tangible movable, to request the seizure and sale of such Collateral in accordance with the subsequent provisions of this Chapter (8).

Two: Stamp Duties

Pursuant to the Stamp Duties Law No. (27) of 1952, agreements, contracts, guarantees, promissory notes etc. are subject to stamp duty set at the rate of 3 per mille for amounts which exceed JD 100.

In the context of small and micro enterprises in Jordan these duties are considered quite high. For example, if a bank wishes to extend a loan to a borrower, the bank would need to enter into a loan agreement regulating and evidencing such lending which shall be subject to stamp duty at the rate mentioned above. Furthermore, if the bank takes a guarantee or accepts a real estate mortgage or demands for a promissory note to be signed by the borrower for a further guarantee of the debt, the bank would need to pay stamp duties of 3 per mille on the loan agreement and on each of the documents associated therewith.

Thus, the total amount of stamp duty fees involved in any one transaction may become quite high and a serious obstacle that, *inter alia*, prevents banks from providing financial services to micro enterprises. Therefore it is suggested that in order to summarize the cost involved in extending credit facilities to small enterprises the Stamp Duties Law should be amended to the effect that micro enterprises are exempt from such duties or at least to require payment of stamp duties only on the loan agreement and not the other associated documents.

Relevant Legislation:

Stamp Duties Law No. (27) of 1952

Article (2)

The word "document" in this Law shall mean all documents and papers subject to stamp duty fees in accordance with the first annex of this Law.

. . .

Stamp Duties
Annex No. (1)

First: Rate

1- Agreements, guarantees, bills of lading for imports, bills of exchange, endorsements, promissory notes, sale agreements, mortgage deeds relating to movable property, letters of undertaking, leases, sub-leases and their assignments, arbitral awards issued by arbitrators not appointed by the Court, appraisal of any property, right of use or the annual rent value or the evaluation of the cost of any construction or destruction of any building or the evaluation of the cost of the work and the value of the used materials in accordance with the following:

Description	JD	Fils
- Amounts not less the JD 1 and not exceeding JD 10		50
- Amounts exceeding JD 10 but not exceeding JD 20		100
- Amounts exceeding JD 20 but not exceeding JD 30		150
- Amounts exceeding JD 30 but not exceeding JD 40		200
- Amounts exceeding JD 40 but not exceeding JD 100		250
- Amounts exceeding JD 100, the following amount shall be charged for each JD 100 or any fraction thereof		300

Three: Court Fees

One of the main issues that prevent financial organizations, and especially banks, from providing financial services to low income entrepreneurs is court fees. In general terms, it has been found that court fees considerations are quite substantial for banks that are considering loans of small value, especially those to small and micro enterprises.

In order to simplify how court fees are determined by courts, it is necessary to distinguish between the two types of courts that exist in Jordan: the first type is called Magistrate Courts which have the competence to look into cases and claims not exceeding JD 750 of value and the second is called the Courts of First Instance which have the competence to look into all claims that fall beyond the competence of Magistrate Courts.

As to claims looked into before Magistrate Courts, the Court Fees Regulation No. 55 of 1992 provides that:

> "In Magistrate Courts claims, a fee of 3 per cent of the value of the claim is prescribed provided that such fee is not less than JD 5 and is not more than JD 25."

As for claims which fall within the competence of the Court of First Instance, the said regulation provides that:

> "In claims that fall within the competence of the Courts of First Instance, a fee of 3 per cent is prescribed for the first JD10000 of the claim, 2 per cent of the second JD 10000 of the claim and 1 per cent for any amount falling beyond the second JD10000 of the claim, provided that the said fee does not exceed JD 1200."

In addition to the said fees, the regulation provides for an additional fee of 1 per cent of the amount of the fees payable in accordance with the above mentioned rates.

The aforesaid fees shall also be payable upon filing an appeal before the Jordanian Court of Appeal. Should the case be brought before the Court of Cassation, it will be subject to the same amount of fees paid at the first stage of trial.

Furthermore, when a judgement is obtained, it shall be subject to a 2 per cent fee of its value, provided that such fee is not less than JD 5 and is not more than JD 1000.

Based on the above, and taking into consideration that a claim may be pursued at three different levels of trial, the combined amount of court fees can be a serious concern to banks when considering extending credit facilities to micro enterprises.

Relevant Legislation:

Regulation Amending the Court Fees Regulation No. (55) of 1997

Fee Schedule

Article (1)

In relation to claims and counter-claims:

A- At the Magistrate's level

A fee amounting to 3% of the amount of the claim shall be paid provided that same is not less than JD 5 and not more than JD 25 unless stipulated otherwise.

B- At the First Instance Level

A fee amounting to 2% shall be paid for the first JD 10000, and a fee amounting to 3% shall be paid for the second JD 10000 and a fee amounting to 1% shall be paid for amounts exceeding same provided that this does not exceed JD 1200 . . .

Article (14) Magistrate Judgements

A nominal fee amounting to 2% of the amount of the judgement shall be paid upon delivering the first copy of the judgement provided that this fee is not less than JD 1 and not more than JD 100 . . .

Article (19) First Instance Judgements

A nominal fee amounting to 2% of the amount of the judgement or the amount of the sum to be enforced shall be paid upon delivering the first copy of the judgement provided that this fee is not less than JD 5 and not more than JD 1000 . . .

Article (22)

A- The fees relating to the appeal of a civil case shall be determined in accordance with the rules under which the fee was determined at the First Instance level and this fee shall be determined according to the amount of the appeal case . . .

Article (23)

A- The fees relating to the appeal of a civil case to the Court of Cassation shall be determined in accordance with the rules under which the fee was determined at the First Instance level and this fee shall be approximated according to the amount of the appealed case . . .

Four: Enforcement of Claims and Judgement Execution System

Banks are usually reluctant to provide financial services to small and micro enterprises in Jordan, especially when borrowers solicit lending without sufficient collateral. This is because banks fear that borrowers may not be able to meet the obligation to repay the loan principal and the interest accrued thereon as and when they fall due. As such, the banks would need to initiate legal proceedings against such borrowers claiming for the amount of their loans and the interest accrued thereon.

Due to the absence of debt recovery agencies and self-help recovery of collateral in Jordan, banks will be forced to claim in the courts for their unpaid debts by themselves. In ordinary cases, the time frame involved in enforcing the bank's claim in the courts would not be less than two to three years. Despite the existence of Magistrate Courts, which are considered small claims courts, it usually takes not less than two years for the court to give its judgement in connection with the bank's claim. In addition, both the plaintiff bank and the defendant will be able to file an appeal before the Court of Appeal challenging the trial court's judgement. The time period involved with regard to proceedings before the court of appeal is usually from 6 months to one year. Furthermore, the judgement given by the Court of Appeal may also be appealed before the Court of Cassation which process would take about six months in order to obtain a final enforceable judgement.

Aside from the time length involved with legal proceedings before Jordanian courts, it should be noted that the lending bank would not be able to recover the amount of the attorneys fees which are incurred in the process of enforcing the bank's claim in full. This is because Article 46(4) of the Jordanian Bar Association Law No. (11) of 1972 provides that trial courts, upon the request of the opponent party, may award for legal fees and determine the amount of same, provided that such fees are not less than 5 per cent of the awarded amount and do not exceed the sum of JD 500 in any case regardless of the amount awarded.

The said Article also provides that legal fees incurred during the appeal stage may not exceed half of the amount of the legal fees awarded by the trial court. Furthermore, the Jordanian courts' practice has always been not to award for more than 5 per cent of the judgement value as legal fees to the successful party regardless of the actual attorney fees incurred. This being the case, that the actual attorney fees paid by the bank will substantially exceed the amount of attorney fees determined by the court, banks will always be reluctant to provide financial services to micro enterprises.

Of relevance to the process of enforcing claims is also the judgement execution system which is also considered an impediment to the growth of micro enterprises and the development of a micro finance industry.

Pursuant to the Execution Law No. (31) of 1952, the judgement debtor may propose to the Execution Office a settlement which suits his financial ability and the amount of his debt. In practice, the debtor's suggested settlement usually provides for settling the debt through installments of small value. For example, if the amount of the debt is JD 1000, the debtor may propose a settlement of same through monthly installments of JD 30 OR JD 20 each. The lending bank usually has no alternative but to accept such settlement, especially if the debtor is not proven to possess or own assets that can be sold in public auction for the purposes of satisfying its debt.

In the above mentioned hypothetical scenario, the time length involved in the bank's recovery of its debt of JD 1000 would not be less than 30 months from the date of judgement should the debtor punctually complies with the terms of his settlement.

Thus, the time frame involved in the bank's recovery of its debt as of the first day of initiating legal proceedings against the defaulting debtor until the full recovery of same will exceed four years.

In addition to the Execution Law No. (31) of 1952, a supplementary law entitled " the Supplementary Execution Law No. (25) of 1965" was enacted in order to provide creditors with the power to enforce their claims, directly through the Execution Office, without the need to obtain a final court judgement if such claims are evidenced by an ordinary document, a notarized document or a negotiable commercial paper. However, the problem with the said Law is that it gives the debtor the right to deny the existence of the debt whether in whole or in part and in such case the Execution Office shall seize the execution procedures and shall request the creditor to refer its claim to the competent court thereby negating the whole purpose of the Law.

Given that the debtor has the right to deny the existence of the debt as explained above and that in practice this is almost always the case, the Supplementary Execution Law is left without any practical benefit to creditors.

In summary, the enforcement system in Jordan is very sophisticated and raises cost and time concerns to banks when considering providing credit facilities to others. Therefore, it is thought that banks should be given self help remedy and the ability to enforce their interests against the defaulting borrowers without the need to obtain a court judgement. In this way, the time element involved in courts proceedings will be eliminated, a matter which would encourage banks to provide financial services to small enterprises.

Relevant Legislation:

Execution Law No. (31) of 1952

Article (119)

1- After serving the notification papers on the debtor, he shall appear at the Execution Office and propose a settlement which corresponds with his financial ability and the amount of the debt in order to pay the amount of the judgement against him or any unpaid sum thereof. If the debtor does not propose a settlement which corresponds as aforementioned or if he offers guarantees and requests payment of the debt in installments for periods not approved by the person in whose favor the judgement was issued, the Execution Officer may order both parties to appear before him at a specified time set by him in order to hear their statements.

2- The Execution Officer shall question the debtor in the presence of the person in whose favor the judgement was issued concerning his ability to pay the amount of the judgement and shall investigate about his assets and his dealing with any of his assets which he has or intents to smuggle to prevent the creditor from being paid the full sum of the debt or concerning his intention to escape.

3- The Execution Officer shall question the creditor and the witnesses whose testimony he considers necessary to hear, either after being given the oath or not, concerning the aforementioned matters in the presence of the debtor or not.

Bar Association Law No. (11) of 1972

Article (46)

1- The advocate shall charge his fees according to the contract concluded between him and his client provided that these fees do not exceed 25% of the actual disputed amount except in exceptional situations where same will be estimated by the Board of the Bar.

2- If the fees of the advocate have not been clearly agreed upon, the Board of the Bar shall determine same after consulting with both parties. The effort exerted by the advocate, the importance of the case and all other factors shall be taken into consideration in their determination.

3- If the case, the subject matter of the agreement, results in a number of other associated cases, the advocate is entitled to claim fees for same.

4- The Court may, upon the request of the opposing party, issue a judgement for the advocate's fees at its discretion provided that such fees are not less than 5% of the amount of the judgement at the preliminary stage and do not exceed JD 500 in any case regardless of the amount of the judgement and provided that the advocate's fees in the appeal stage do not exceed half the judgement of the preliminary court.

<u>Supplementary Execution Law No. (25) of 1965</u>

Article (2)

A- A creditor whose owed an amount of money evidenced by an ordinary document, a notarized document or a negotiable commercial paper may refer to the Execution Office and request same to recover its debt.

. . .

Article (6)

If the debtor denies the existence of the debt in whole or in part, the creditor shall be ordered to refer to the competent court in order to prove his claim.

Five: Non Governmental Organizations (NGOs)

NGOs are established and registered according to the Charitable and Social Associations Law No. (33) of 1966. An application for the registration of the association combined by the articles of association should be submitted to the Minister of Social Development who shall look into the application and the objectives of the association and issue his decision with regard thereto.

Pursuant to Article (2) of the said Law there are two types of associations that may be established and registered with the Ministry of Social Development. Firstly, the so called charitable associations which main objective is regulating their activities to offer social services to citizens without aiming through their operations and activities to generate financial profit. The second type of associations is the so called social associations which aim is to offer and provide social services such as training, charitable and practical services without generating any financial profit therefrom.

It should also be mentioned that Article (19) of the said Law allows a foreign association to establish a branch office for providing social services in Jordan according to the conditions and restrictions set out by the Minister of Social Development. In this context, it is important to mention that Article (240) of the Companies Law No. (22) of 1997 which deals with registration of branch offices of foreign companies in Jordan is of no relevance to the registration of a branch of a foreign NGO in Jordan. Article (240) is only applicable to the registration of an operating branch in the name of a foreign company or a corporate entity in Jordan.

Special NGOs are established by virtue of special laws or Royal Decrees, such as, Queen Alia Fund and Noor Al-Hussein Foundation. Queen Alia Fund is established according to Law No. (37) of 1985. Article (3) of the said Law defines the legal ambit of the fund's powers which is to enter into and carry out any legal transaction including execution and delivery of contracts, right of acquisition, right to borrow, right to accept donations, grants and *waqf*.

On the other hand, Noor Al-Hussein Foundation was established by virtue of a Royal Decree that was issued by His Majesty King Hussein in 1985. The underlying objective of the said Foundation is to supervise the various projects and programs that were established by her Majesty Queen Noor in the fields of culture, education and social development.

As to the financial role played by NGOs in the development of microfinance industry in Jordan, it is apparent that NGOs are not authorized to engage in the provision of financial services for the following reasons:

- According to the Banks Law No. (24) of 1971, the institutions that are authorized to lend and provide financial services to others are banks and financial institutions both of which should be public shareholding companies established under and pursuant to the Companies Law No. (22) of 1997 and are licensed by the Central Bank of Jordan.

- The Charitable and Social Associations Law No. (33) of 1966 does not confer on NGOs the right to provide financial services to others nor does it confer on NGOs the right to generate or obtain financial services.

As to Queen Alia Fund, Queen Alia Fund Law does not specifically give the Fund the right to provide financial services to others. Article 4(a) of the said Law defines the objectives of the Fund and reads as follows:-

> "The Fund shall participate in the support and development of voluntary social work in the Kingdom in all social sectors and through its available means."

Based on the said Article, it not clear whether the Fund may engage in providing financial credit on the basis of its underlying objectives. However, it is suggested that the said Law should be amended to the effect that the Fund is explicitly given the ability to engage in providing financial assistance to small and micro-enterprises.

As to Noor Al-Hussein Foundation, the Royal Decree under which the said Foundation is established does not specify or address the objectives of the Foundation in a detailed manner. Furthermore, we have not been able to review the by-laws of the said Foundation as they are not published and could not be obtained through the Foundation. In light of these circumstances, it is difficult to opine on whether the said Foundation may engage in the provision of financial services.

With regard to Jordan Women's Development Society (the "JWDS"), since this association is established under the Charitable and Social Associations Law, all of the general remarks made with regard to NGOs as to their powers to provide financial services are applicable to this society.

In addition to the fact that NGOs may not engage in the provision of financial services as previously stated, Article (640) of the Jordanian Civil Code which would be applicable to the loan transaction would not allow the lending NGO to claim interest on such lending. The reason for this is that NGOs' lending could not be classified as "commercial loans" and, as such, the loan may not, in any case, yield any interest. Article (640) provides as follows:-

> "If a benefit *[such as interest]* exceeding the amount stipulated in the loan agreement is provided for therein, for a purpose other than securing the lender's interests, such stipulation shall be void and the agreement shall be valid."

In general terms, it is apparent that the current structure of the Charitable and Social Associations Law No. (33) of 1966 is inadequate in allowing NGOs to provide financial assistance to small and micro enterprises. NGOs could play a more substantial role in the micro financing development because, from a micro enterprise point of view, obtaining a loan from NGOs is more attractive than obtaining financial services from banks. This is because NGOs' return on the loan is usually less than the interest charged by banks on such loans. Furthermore, NGOs' lending terms are usually longer than banks' lending terms since the financial resources of NGOs are mostly donations, grants or credit facilities that are obtained at a very low interest rate.

Relevant Legislation:

Charitable and Social Associations Law No. (33) of 1966

Article (2)

. . .

The phrase "Charitable Association" means any association consisting of seven or more persons whose main purpose is regulating its objectives to offer social services to citizens without aiming from its activities or operations to generate financial profit, distribute same, generate personal benefit or accomplish any political goals. This definition does not include political associations or associations established by virtue of a special law.

The phrase "Social Associations" means every association consisting of 7 persons or more which provides social services whether such services are practical services, training services or charitable services. This definition shall also include social centers provided that the aim thereof is providing services to the community without generating financial profit, distributing same or gaining any personal benefits or having any political aims.

. . .

Article 19

The Minister, upon the recommendation of the General Manager, may license any foreign association to establish one or more branches in the Kingdom to carry out social services therein in accordance with the conditions, limitations and fees set by the Minister in return for the services carried out or offered by the branch, provided that the application for a license submitted by the foreign association in this case contains the information determined by the Minister including the following:

A- The original name of the association and the location of its head office and its branches.

B- The names and addresses of the members of the administrative committee in its head office.

C- The objectives of the original association in detail.

D- The names of the persons responsible for the branch or branches of the association in the Kingdom and their nationalities.

E- The objectives of the branch or branches of the foreign association or entity currently established or to be established in the Kingdom and the projects relating thereto.

F- The manner of disposing of the funds and assets of the branch or branches of the entity in the Kingdom upon its withdrawal, dissolution or the liquidation of its operations in the Kingdom . . .

Queen Alia Fund Law No. (37) of 1985

Article (3)

A fund shall be established in the Kingdom under the name (Queen Alia Fund for Social voluntary Jordanian Work) which has a juristic personality with financial and administrative independence, and which, in such capacity, may perform all legal actions including entering into contracts, right of acquisition, taking loans, accepting donations, gifts, wills and Waqf and taking legal actions and appointing any lawyer or another agent for that purpose.

Article 4(a)

The Fund shall participate in the support and development of voluntary social work in the Kingdom in all social sectors and through its available means."

Banks Law No. (24) of 1971

Article (3)

A- Only a licensed bank is permitted to carry out banking activities in Jordan.

B- The license shall be issued by the Central Bank of Jordan in accordance with the provisions of this Law.

C- A license may only be issued to a public shareholding company with the exception of the branches of foreign banks.

D- Branches of foreign banks licensed to operate in the Kingdom are not subject to the provisions of the previous paragraph.

E- Banks licensed to practice banking activities after the promulgation of this Law shall be considered licensed banks pursuant to this Law.

Civil Code No. (43) of 1976

Article (640)

If a benefit [*such as interest*] exceeding the amount stipulated in the loan agreement is provided for therein, for a purpose other than securing the lender's interests, such stipulation shall be void and the agreement shall be valid.

Six: Othmani Law

Part of the Banking legal system in Jordan is the Othmani Murabaha Law. By virtue of this Law compound interest on loans may not in any case exceed the value of the loan principle. This may be considered an impediment to the development of micro enterprises as banks would not be able to offer long term lending since the interest that will accrue shall be equal to the amount of the loan principle in a very short term taking into consideration the high interest rate applicable to financial lending.

Relevant Legislation:

Othmani Murabaha Law

Article (4)

The interest due on loans, regardless of the number of years that have elapsed, must not exceed the capital and all judges are prohibited from issuing a judgement with an interest that exceeds the capital.

Seven: Encouragement of Investment Law

In anticipation of joining the World Trade Organization and expecting increase of investment in Jordan many laws have been amended and modernized to encourage local and foreign investment and to provide for an improved investment atmosphere. Among these laws is the Encouragement of Investment Law No. (16) of 1995 and the regulations issued thereunder.

The Encouragement of Investment Law offers investment incentives to certain projects established in the Kingdom in the sectors of industry, agriculture, hotels, hospitals, maritime transport and railways and any other sectors added to the above by a resolution of the Council of Ministers.

Notwithstanding the investment incentives embodied in the Encouragement of Investment Law such as import fees, customs duties, sales tax and income tax, the said Law does not offer any incentives in the context of micro finance lending. For example, the Investment Law does not give any tax privilege to banks on their lending to small and micro enterprises. Also, the said Law does not exempt banks from stamp duties due on all documentation related to loan transactions entered into with micro enterprises.

Eight Insurance Law

In Jordan there is no body of law which regulates issues of insurance transactions independently. Rather, the Jordanian Civil Code contains a section that regulates insurance agreements. This section does not address specifically insurance of equipment on loans. However, pursuant to the general provisions of this section, the insurance of equipment and loans are valid and binding transactions as long as they do not contradict with any provision that is considered a matter of public policy.

Nine: Reactions of Bank to the Issues Associated with Microfinancing

Based on interviews conducted for the purposes of this consultancy, it is clear that banks are discouraged from providing financial assistance to small and micro enterprises. This attitude is due to several practical and legal considerations:

Cost Considerations

From a bank's perspective, the cost involved in maintaining and following up small loans is high compared to the banks' return on such loans. Therefore, banks would focus on large loans as their cost could be very minimal compared to the banks' return on such loans.

Social Considerations

Banks are quite reluctant to engage themselves in the microfinance industry due to sensitive social considerations. If a small enterprise fails to repay the loan principal together with the interest accrued thereon at the maturity date, the lending bank would be forced to foreclose on the loan collateral which is usually the machinery or the equipment financed by the bank. This action by the bank could socially be considered unacceptable taking into consideration the banks financial sophistication compared to the borrower's financial weakness. Banks would be subjected to criticism in the community for confiscating or otherwise enforcing their interests on the collateral.

Lack of an Adequate Security System

Banks believe that the current legal system relating to the security of loans is inadequate in protecting the banks' interests especially that banks are not given self-remedy in case of default of the borrower and, as such, courts would be the only resort available to banks in order to recover their loans.

Lack of a Centralized Data Base for Credit Assessment

Due to the absence of an accessible data base (Credit Bureau) through which a bank could easily obtain full and up-to-date credit information in connection with the credit worthiness of a new customer, it is usually difficult for a bank to accurately evaluate the credit standing of such new customer. This being the case, the bank will either refuse to extend credit facilities for such a customer or, alternatively, would call for a collateral that secures the banks interests in full.

Reserve Accounts Concerns

The Central Bank of Jordan (the "CBJ") has issued regulations whereby banks are required to allocate a fund reserve to cover any unsettled or unpaid debts. The said regulations are quite sophisticated and technical but it is only necessary to mention that in the event that a borrower fails to repay the loan together with the accrued interest and such default continues for a period exceeding 180 days, the lending bank will be required by the CBJ to allocate 100% of the value of the loan as a fund reserve. However, it should be noted that such requirement does not apply to secured loans as the bank's interests will be guaranteed by the collateral. This being the case, the said CBJ's regulations leave banks with no option but to call for a collateral securing the loan in order to be exempted from the fund reserve requirement stated above.

Conclusion

The current legal system in Jordan contains several laws that do not offer any incentives to those engaged in the microfinance industry. On the other hand, some of these laws are considered real impediments to the growth of this industry. Based on the review and examination of the Jordanian laws conducted for the purposes of this consultancy, it is clear that the lack of a modern secured financing system whereby security interest can be obtained and enforced without the intervention of courts constitutes the main drawback that negatively affect the development of this industry.

The intricacies associated with the current enforcement system are also discouraging banks from playing a more active role in providing financial services to small and micro enterprises. In addition, NGOs are not offered legal devices to enter into the microfinance industry.

It is anticipated that once the proposed Security Interests in Movable Property Law comes into force, the substantial bulk of issues affecting microfinance industry shall be eliminated as banks will be able to obtain recognized security interests and self-recover their lending.

A Review of
The Laws and Regulations Related to the Provision of Financial Services to Small and Micro Enterprises in Jordan

Prepared by:

Ali Sharif Zu'bi & Sharif Ali Zu'bi Law Office
Amman - Jordan